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SUBJECT: IMF LIKELY TO ASSIST EL SALVADOR WITH NEW STAND-BY ARRANGEMENT

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¶B. 08 SAN SALVADOR 1332

¶1. (SBU) SUMMARY. El Salvador is likely to receive a new Stand-By Arrangement from the International Monetary Fund (IMF), according to a visiting IMF assessment team. The IMF also expects to issue letters supporting the release of $300 million in Inter-American Development Bank loans and the issuance of $800 million in Eurobond debt. Neither El Salvador's rising budget deficit nor failure to pass regulatory reforms is likely to affect the IMF's decision. IMF support for El Salvador's fiscal difficulties is preferable to the GOES seeking assistance from other players like Venezuela. On the other hand, El Salvador could benefit from IMF leverage to push various fiscal and legal reforms, but that is not part of the deal. END SUMMARY.

¶2. (SBU) A visiting IMF assessment team advised Econoffs August 26 that the IMF would likely give El Salvador a new Stand-By Arrangement (SBA) by their November board meeting, replacing El Salvador's $800-million one-year provisional SBA approved last December. The new SBA would likely be on the order of $800 million over three years, though details would be worked out in during a planned September assessment. A three-year SBA would be less expensive for El Salvador in the long-run.

¶3. (SBU) Based on their current visit, the IMF team expected to issue a letter to the Inter-American Development Bank (IDB) in support of releasing the final $300-million tranche of the $500 million loan approved in December. This tranche would be used to support social programs as previously approved by the National Assembly (reftel A). The IMF team likewise planned to come out in support of El Salvador's plan to issue $800 million in Eurobonds later this year. The proceeds of the bond issuance would be used to reduce El Salvador's high levels of short-term (one year or less) Letters of Treasury ("letes"), which had caused serious fiscal problems for the previous government (reftel B).

¶4. (SBU) Asked whether El Salvador's rising fiscal deficit, now estimated to hit 6%, would be a problem for the IMF, the team replied that the Fund recognized much of El Salvador's fiscal and economic problems were because of the international financial crisis, and so they were not overly concerned. One economist noted that the GOES's internal projections showed a significant deficit for 5 years before it started going back down. The IMF team was also unconcerned by potential balance of payments problems because of falling remittances, a concern noted by Fitch ratings. One economist stated that "(balance of payments problems) tended to correct themselves," and that lower consumer demand and imports would more than compensate for reduced remittances.

¶5. (SBU) Likewise, the IMF team indicated that El Salvador's failure (or potential failure) to pass IMF-recommended reforms for regulation of the financial sector was unlikely to affect a possible SBA. The principal reform, a law merging the existing

Superintendents of the Financial System, Pensions, and Stock Market into a single entity, had stalled in the National Assembly at the end of May. One team member stated that the IMF now recognized its limited ability to make countries pass reform laws.

¶6. (SBU) COMMENT: This "new" IMF, apparently unconcerned with deficits and reforms, marks a noticeable change from the IMF's historical attitude. One of the team members, a 20+ year IMF veteran, remarked that "the kind of things the Fund would agree to now" would make the people he started with "roll over in their graves." While IMF support for El Salvador is preferable to the GOES seeking assistance from other players like Venezuela, the loss of IMF leverage to push various fiscal and legal reforms is a missed opportunity. END COMMENT.

BLAU